

Discontinued Operations

Regardless the industry, mergers and acquisitions are very complex legal transactions that, besides substantially altering regular operations, can also affect an organization's insurance needs. Unforeseen liabilities may arise for merged entities that produce tangible products. One area of concern is a discontinued operation.

Once a product enters the marketplace, the liabilities associated with that product do not cease with the sale or merger of the original manufacturer. Such liabilities still exist even when that particular product is no longer produced. Liability claims often occur many years after the product was first produced or sold. In other words, liability still exists for operations that have been discontinued.

Often businesses are sold on an 'assets only' basis. If the original business owners retain the corporate structure, then liabilities connected to their original operations will remain with that corporate entity. A business may arrange separate coverage for a discontinued operation related to the transaction.

For example, Utility Trailers, Inc. manufactured small trailers. The owners of Utility Trailers received an attractive offer from another company and its board decided that a sale was in everyone's best interest. The sale was completed on an 'assets only' basis. Utility Trailers, Inc. was not dissolved as a corporate entity. A year after the sale of the company, some customers filed claims for damages due to product defects on trailers that were made by the original entity. The claims reverted to the original corporation and without Discontinued Operations coverage; it could have become the liability of the original owners of the corporation.

Courts take different positions on these issues according to individual cases. In some instances the courts find the new owner responsible, particularly when they continue the operations of the original entity. Some jurisdictions have laws that prohibit lawsuits after a certain number of years (statutes of limitation) and they may provide some protection. However, others allow a time limit for filing a suit which lay dormant, not being triggered until some harm has been discovered. Once that occurs, the clock begins to tick for taking legal action. The latter instance means that years could pass before a substantial claim arises.

'Discontinued Operations' coverage would provide coverage for bodily injury or property damage caused by defective products. The same coverage can be designed to provide coverage for contractors that have ceased doing business. It would be a disappointing situation to find that after a product has been discontinued or assets sold, all profit from the sale – and perhaps more – has been taken away due to a defective product that is still the responsibility of that entity. So contact your agent and discuss whether you have continuing liability for a discontinued operation.

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